In the Supreme Court
OF THE
United States

OCTOBER TERM, 1944

No.

ACME BREWING CO. (a corporation),
Petitioner,

vs.

CLIFFORD C. ANGLIM, Collector of Internal Revenue for the First District of California,
Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

OPINIONS OF THE COURTS BELOW.

The Circuit Court of Appeals (R. 161); 143 F. (2d) 412.

No opinion by the United States District Court. Findings and judgment. (R. 12, 18.)

JURISDICTION.

A statement of the basis on which this Court has jurisdiction to grant the writ is set forth at page 7 of the petition.

STATEMENT OF THE CASE.

For the purposes hereof petitioner relies upon the statement of the case on pages 2-6 of the petition.

SPECIFICATIONS OF ERROR.

The Circuit Court of Appeals erred in the following particulars:

1. In holding that a contract in writing made for the express benefit of a corporation, and the terms and provisions of which are accepted and adopted by the corporation so as to become legally binding upon it, is not a contract "executed" by the corporation within the meaning of Section 26(c)(1) of the Revenue Act of 1936.

2. In concluding from certain language, disassociated from its context, used by this Court in the *Northwest Steel Rolling Mills* case, that it was the intent of this Court to rule that "signing" by a corporation is essential to "execution" within the meaning of Section 26(c)(1) of the Revenue Act of 1936.

FEDERAL STATUTES INVOLVED.

Revenue Act of 1936:

"Sec. 26. Credits of Corporations.

"In the case of a corporation the following credits shall be allowed to the extent provided in the various sections imposing tax—

"(c) Contracts Restricting Payment of Dividends.

"(1) Prohibition on payment of dividends. An amount equal to the excess of the adjusted net income over the aggregate of the amounts which can be distributed within the taxable year as dividends without violating a provision of a written contract executed by the corporation prior to May 1, 1936, which provision expressly deals with the payment of dividends. * * *"

ARGUMENT.

PURPOSE OF SECTION 26(c)(1).

It was only reasonable, and obviously was the intent of Congress, to avoid penalizing a corporation which was legally bound by a written agreement to refrain from distributing its earnings in dividends. In order to guard against fraudulent claims two precautions were taken: (1) the agreement had to be made prior to May 1, 1936, which was before the Act which imposed the tax became effective; (2) it had to be evidenced in writing. The purpose in back of both of these precautions is reasonable and logical. The Act, after its provisions were known, could be readily evaded by purposely entering into an agreement containing such a restriction, and an oral agreement could with too much facility be fraudulently and collusively proved.

There would be neither reason nor logic in limiting the method or procedure by which a corporation could become legally bound by the terms of the written contract. On the contrary, such a limitation would be arbitrary and discriminatory. The corporation could

only become legally bound by certain actions upon its part. The legal effect of such actions would be for the Court to determine. It could not have been the intent of Congress to confine the credit to corporations which by more or less fortuitous circumstances, had followed the particular procedure of "signing" to evidence the fact that the terms of the writing were legally binding upon it.

THE CONTRACT WAS LEGALLY BINDING ON PETITIONER.

The contract was entered into for the benefit of petitioner. The provisions for its benefit were open for its acceptance. Such acceptance could be manifested in different ways, as, for example, legal action based upon the contract, or actual acceptance of its benefits. When accepted, petitioner became entitled to the rights in its favor and at the same time subject to the corresponding liabilities and restrictions in favor of the other parties to the contract.

More v. Hutchinson, 187 Cal. 623, 625, 628, 203 P. 97;

Central Bank of Oakland v. Wells Fargo Bank & Union Trust Co., 18 Cal. App. (2d) 559, 561, 563, 64 P. (2d) 465.

An agreement that in direct and unmistakable terms is made for the benefit of another is made expressly for his benefit. It is unnecessary that it be made exclusively for his benefit or that he be named in the agreement.

Le Ballister v. Redwood Theatres, Inc., 1 Cal. App. (2d) 447, 448, 36 P. (2d) 827;

Chung Kee v. Davidson, 73 Cal. 522, 525, 15 P. 100;

Marysville Electric Light & Power Co. v. Johnson, 93 Cal. 538, 546, 29 P. 126;

Kohler v. Agassiz, 99 Cal. 9, 15, 33 P. 741.

Resolutions and acts on the part of petitioner, which constituted an acceptance of benefits and entailed a corresponding assumption of liabilities, included the following:

RESOLUTIONS.

1. Changing the capital structure, in exact accord with the agreement. (R. 54.)

2. To issue 15,000 shares to Cereal in satisfaction of $150,000.00 of indebtedness to Cereal, in exact accord with the agreement. (R. 56.)

3. To purchase from Cereal, cooperage, bottles and cases for $100,000.00, in exact accord with the agreement. (R. 55.)

4. To sell to Cereal 10,000 additional shares for $100,000.00, in exact accord with the agreement. (R. 57.)

5. To sell to Bohemian 10,000 shares for $100,000.00, in exact accord with the agreement. (R. 55.)

6. To increase the Board of Directors to seven members, in exact accord with the agreement. (R. 54.)

7. To borrow $350,000.00 from Cereal, and execute note, deed of trust and chattel mortgage, in exact accord with the agreement. (R. 56.)

The note, deed of trust and chattel mortgage were executed under date of May 7, 1935.

All authorized acts were taken long prior to May 1, 1936.

One of the rights and benefits accepted and retained by petitioner was the loan of $350,000.00 from Cereal. One of the corresponding obligations or liabilities assumed was the restriction against payment of dividends until the loan was fully repaid.

One method by which petitioner could have evidenced its acceptance of the provisions of the contract was by subscribing its acceptance to the instrument. Let us assume that petitioner had subscribed the following to the written instrument: "Accepted Acme Brewing Company, by Karl F. Schuster, President." If the foregoing had occurred, no one would question the sufficiency of the "execution". No one would doubt that petitioner would then be entitled to the credit under Section 26(c)(1). Yet, the legal effect of such subscription would have been identical with the legal effect of the acts actually taken by petitioner. The acts taken by petitioner completely embraced the provisions of the agreement, and express reference to the agreement would have added nothing and would have been superfluous. The difference between a subscription of acceptance and the steps actually taken by petitioner would consist only in the method or means by which the fact of acceptance would be evidenced. Is a distinction to be drawn between acts, which have the same legal effect? Is the one to be regarded as "execution" entitling the taxpayer to a credit under the Revenue Act, and the other to be regarded as insufficient for that purpose? This Court has many times held that classifications

"must be reasonable, not arbitrary, and must rest upon some ground of difference having a fair and substantial relation to the object of the legislation, so that all persons similarly circumstanced will be treated alike * * *. The classification in order to avoid the constitutional prohibition, must be founded upon pertinent and real differences, as distinguished from irrelevant and artificial ones. The test to be applied in such cases as the present one is—does the statute arbitrarily and without genuine reason impose a burden upon one group of taxpayers from which it exempts another group, both of them occupying substantially the same relation toward the subject matter of the legislation? Mere difference is not enough."

Colgate v. Harvey, 296 U. S. 404, 80 L. Ed. 299, 307, 102 A.L.R. 54, 61;

Air-Way Electric Appliance Corp. v. Day, 266 U. S. 71, 85, 69 L. Ed. 169, 177;

Schlesinger v. Wisconsin, 270 U. S. 230, 240, 70 L. Ed. 557, 564.

The question is whether so narrow a construction is to be placed on the term "executed" as to exclude acts (other than signing), which have the legal effect of binding the corporation by the terms of the written contract.

ANALYSIS OF OPINION OF SUPREME COURT IN NORTHWEST STEEL ROLLING MILLS CASE.

Inasmuch as the Government places entire reliance upon the language of this Court in the *Northwest Steel Mills* case, the opinion of the Circuit Court of

Appeals quotes it, and its significance has been variously interpreted, we shall endeavor to analyze the opinion.

It must be borne in mind that this Court was reviewing a decision of the Circuit Court of Appeals. That Court had decided, forthrightly, that a written contract did not have to be signed by the corporation in order to be "executed" by it. In fact, it could be signed by individuals before the corporation came into existence and thereafter accepted and adopted by the corporation. In coming to that conclusion the Circuit Court of Appeals relied upon and expounded certain definite principles of law. It said in part:

> "Be that as it may, the fact remains that by accepting the corporate charter, the corporation *became bound* by the acts of the incorporators in so executing the articles, *whether we rely upon a theory of novation, ratification or continuing offer* * * * *We do not believe that Congress intended the word 'executed' to have such a narrow meaning as to exclude the act of becoming bound by ratifiaction.* * * * As stated in 23 Cor. Jur. 278: 'The words "execute", "executed" and "execution" when used in their proper sense, convey the meaning of carrying out some act or course of conduct to its completion. Thus when the terms are applied to a written instrument, they include the performance of all acts which may be necessary to render it complete as an instrument importing the intended obligation, of every act required to give the instrument validity or to carry it into effect or to give it the forms required to render it valid.'
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> * * * * * * *

"This impels the conclusion that the Act in question should be construed so as to include the taxpayer's corporate charter within the term 'written contract executed by the corporation, etc.' *There seems to be grave doubts as to whether there is a reasonable basis for discrimination between a written contract actually 'signed' by a corporation prohibiting the payment of dividends, and the contract of the charter to which the corporation is as fully bound, likewise prohibiting the distribution of profits.* The 'administrative convenience' which we have above held lends a basis for the distinction betwen oral and written contracts, would not seem to apply with equal force to this situation.

* * * * * * *

"The Supreme Court has said that a statute should be construed to avoid not only the conclusion that it is unconstitutional, but also grave doubt as to its constitutionality. Linder v. United States, 288 U. S. 17, 45 S. Ct. 446, 69 L. Ed. 619, 39 A. L. R. 229."

In reviewing this decision, this Court did not disapprove of either the foregoing conclusions or the legal principles declared. On the contrary, the decision proceeds upon the assumption that a corporate charter is a written contract "executed" by the corporation. The opinion states the question under consideration in the following words:

"Upon the premises that respondent's Washington charter was a written contract, and that the Washington laws prohibiting dividend payments were by operation of law a part of that contract, the court below concluded that the tax-

payer had satisfied the requirements of Section 26 (c) (1). *We must therefore decide whether Section 26 (c) (1) authorized a credit or deduction to corporations prohibited by state law from distributing dividends.*"

The opinion traces the history of Sections 26(c)(1) and 26(c)(2) and points out that the present language is the equivalent of the words "contractually obligated" originally contained in the Act.

In reasoning that the provision restricting the payment of dividends must be included in the written instrument itself, this Court said:

> "The natural impression conveyed by the words 'written contract executed by the corporation' is that an explicit understanding has been reached, reduced to writing, signed and delivered. True, obligations not set out at length in a written contract may be incorporated by specific reference, or even by implication. The Congress indicated that any exempted prohibition against dividend payment must be expressly written in the executed contract. It did this by adding a precautionary clause that the granted credit can only result from a provision which 'expressly deals with the payment of dividends'."

In summarizing, it is stated:

> *"It is clear, therefore, that what prohibited respondent from distributing dividends was not the provision of an executed written contract expressly dealing with the payment of dividends. On the contrary, what prohibited respondent from paying dividends was a valid law of the State of Washington."*

We believe that it was not the intent of this Court to indicate that there must be any particular method of execution of the written contract—that it must be signed by the corporation. If such had been the intent, the tree would have been hewn at the roots and the case would have been decided upon the ground that there was no written contract. It would not have been decided upon the ground that the restriction was a matter of state law and not a provision contained in the instrument.

SCOPE AND MEANING OF THE TERM "EXECUTED".

The term "executed" when applied to a written instrument includes acceptance, ratification, adoption or any other acts sufficient in law to give validity and binding effect to the written instrument.

> "The words 'execute', 'executed' and 'execution' when used in their proper sense, convey the meaning of carrying out some act or course of conduct to its completion. Thus when the terms are applied to a written instrument, they include the performance of all acts which may be necessary to render it complete as an instrument importing the intended obligation, of every act required to give the instrument validity or to carry it into effect or to give it the forms required to render it valid."
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> 24 *Cor. Jur.* 278.

Ratification, acceptance or adoption may be proved in support of an allegation of "execution".

> *Scadden Flat G. M. Co. v. Scadden,* 121 Cal. 33, 37-39, 53 P. 440;

Scandinavian American Bank v. Wentworth Lumber Co. (101 Ore. 151), 199 P. 624, 626;
Masters v. Walker (89 Ore. 526), 174 P. 1164;
Dodd v. Groos (175 Iowa 47), 156 N. W. 845, 849;
Walker v. Peake (153 S. C. 257), 150 S. E. 756, 763;
Goetz v. Goldbaum (4 C. U. 749), 37 P. 646.

In *Reedy and Bixby v. Smith,* 42 Cal. 245, 250, the Supreme Court of California held that an unsigned contract, recognized and acted upon, had been "executed":

> "Under the circumstances revealed by the evidence, I think the Court properly found that the contract had been *executed* and was binding upon both parties. *Both had acted upon it as a binding contract. The plaintiffs certainly would have been estopped from denying that it had become binding upon them, had suit been brought upon it by the defendants.*"

In *Morgenstern v. Bailey,* 29 Cal. App. 321, 324 (84 P. (2d) 159), the District Court of Appeal of California stated:

> "An agreement in writing which is signed and delivered by the promisor and accepted and acted upon by both parties, is sufficiently *executed* to make it a binding obligation of the parties signing it."
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> "A party who accepts the benefits of a contract is bound thereby even if he has not signed it."
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> *Minton v. Mitchell,* 89 Cal. App. 361, 370, 265 P. 271;

Remsberg v. Hackney Mfg. Co., 174 Cal. 799, 802, 164 P. 792;
Dicker v. Italo-American Oil Corporation, 119 Cal. App. 451, 455, 6 P. (2d) 550;
Wilson v. General Water Heater Corporation, 138 Cal. App. 769, 772-773, 33 P. (2d) 415;
Commercial S. Co. v. Modesto Drug Co., 43 Cal. App. 162, 174-176, 184 P. 964;
Cal. Civil Code, Sections 1589, 3521.

COMMENTS UPON OPINION OF THE CIRCUIT COURT OF APPEALS.

We have stated that this agreement was for the express benefit of taxpayer. The opinion of the Circuit Court of Appeals states that taxpayer "was to a considerable extent the third party beneficiary". This is an understatement. The Circuit Court refers to one provision that is expressly, and as an exception, declared not to be for the express benefit of taxpayer. This one provision renders it optional with the two stockholders, Cereal and Bohemian, to advance to taxpayer money to pay an installment of the note to Cereal, if taxpayer should be unable to meet it. It was a provision to protect Bohemian, the minority stockholder, against default that might result in foreclosure. The agreement recites that this particular provision is not for the benefit of taxpayer. The insertion of this express exception constitutes a recognition that the other provisions are for taxpayer's express benefit, and that this particular provision required an express

exception in order not to fall within the same category. The agreement, however, is so obviously for the express benefit of taxpayer that it is unnecessary to resort to the rule of construction: *Inclusio unius est exclusio alterius.*

In the opinion of the Circuit Court of Appeals, the manner in which the foregoing exception is printed is misleading. The words of exception are followed by the restriction against the payment of dividends with which there is no connection whatsoever. The restriction against payment of dividends continues so long as the note to Cereal remains unpaid, and there is no question but that the provision in the contract by which Cereal agreed to lend the $350,000.00 to taxpayer was one of the many provisions of the contract for the benefit of taxpayer, enforceable by taxpayer and actually accepted by it. If taxpayer had been an express party to the agreement, and had signed it as such, its rights and obligations would have been identical with those received and assumed by acceptance of its benefits. The provision respecting advances to meet an installment of the note would still have been optional to the other parties under the express terms of the agreement.

The opinion recites that:

> "After it was signed a series of resolutions were passed by taxpayer's directors changing the capital stock structure of the corporation, issuing shares of stock to Cereal Products and Bohemian Co., and taking other action. The resolutions *conform exactly* to the plan detailed in the contract,

but mention of the contract is absent and seems to have been studiously avoided."

All the steps were taken long prior to the enactment of the undistributed profits tax. By the series of resolutions referred to taxpayer meticulously authorized the performance of every detail of the contract. It is true that the resolutions do not expressly refer to the contract, but there was no occasion for such a reference and the connection between the contract and the acts authorized was too obvious to require such a reference. It is customary to authorize a conveyance to be executed or a payment to be made for a specified consideration, without setting forth that the authorization is in response to an offer that has been received, and yet when the connection is obvious, no one would suggest that there was an insufficient acceptance of the offer by reason of absence of such an express reference. This, and not any desire to avoid mention of the contract, constitutes the only reasonable explanation of failure to mention the contract specifically in the resolutions.

The opinion indicates that the taxpayer repeatedly and consistently recognized the contract and restrictions as binding upon it. A number of resolutions were passed requesting permission of Cereal to pay a dividend on preferred stock issued by taxpayer. This preferred stock was not issued until the end of 1936 and the first dividend did not become payable until April 1, 1937. The first resolution asking permission of Cereal to pay the dividend was passed March 8, 1937. The opinion states that as this resolution was

passed after May 1, 1936, it "fails to satisfy the terms of the statute". Is this an implication that if such a resolution recognizing the restriction as binding had been passed prior to May 1, 1936, it would have satisfied the statute? If so, a distinction is being drawn that ignores actualities and substance. The resolutions passed constituted such a recognition in fact and in law.

The opinion states that "the certainty of a writing is lacking in the circumstances of the instant case". What certainly is lacking? Surely, the restriction is in clear and indubitable language. Likewise, are set forth in detail what taxpayer is to receive and what it is to do. If taxpayer had at the bottom of the contract appended a written acceptance, the contract terms would have been unchanged and yet it is inconceivable that its sufficiency or certainty would have been questioned. At another point, the opinion definitely states that all requirements of Section 26(c)(1) are satisfied by the contract in this case and the sole question is the sufficiency of its "execution".

> "As pointed out by taxpayer, the relief from payment of tax on undistributed profits provided for in Sec. 26 (c) (1) *requires that a contract creating the obligations which bring such section into operation shall have been executed prior to May 1, 1936, that it be in writing, that it contain a provision expressly dealing with the payment of dividends, and that it be executed by the corporation. The first three conditions are clearly met by the contract. But is the condition met that the contract must be 'executed' by the corporation?"*

In other words, if this contract had appended to it a written signature or acceptance, petitioner would admittedly be entitled to the credit. Yet, it is conceded that petitioner prior to May 1, 1936, became, by accepting the benefits of this contract and executing and adopting its provisions, legally bound thereby and to a like extent as if the instrument had been signed by it.

CONCLUSION.

In the one case in which this statute was before this Court, language was used that has created ambiguity and uncertainty. Different Circuits have drawn different inferences and their decisions are now in conflict. Quoting this language, the Circuit Court of Appeals of the Ninth Circuit has directly reversed its former position, and, we are confident, has placed a construction thereon that was never intended.

Petitioner respectfully submits that the case presented is one proper for review under Rule 38 of this Court and that a writ of certiorari should issue as prayed.

Dated, San Francisco, California,
September 6, 1944.

Respectfully submitted,
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